Director of Income Tax (International Taxation) Vs Maersk Line UK Ltd.

Court: Calcutta High Court

Date of Decision: Aug. 16, 2013

Citation: (2014) 223 TAXMAN 358

Hon'ble Judges: Indira Banerjee, J; Anindita Roy Saraswati, J

Bench: Division Bench

Judgement

1. The Court: This appeal of the Revenue u/s 260A of income tax Act, 1961, is directed against the judgment and order dated 21st September,

2012, passed by the Income Tax Appellate Tribunal, ""C"" Bench, Kolkata, in ITA No. 2150/Kol/2009, relating to the Assessment Year 2006-07.

By the judgment and/or order under appeal, the learned Tribunal has dismissed the appeal being ITA No. 2150/Kol/2009 of the Revenue, against

an order dated 18th September, 2009 of the Commissioner of income tax (Appeal)-XIX, Kolkata, partly allowing the appeal being Appeal No.

447/CIT (A)-XIX/DDIT, Intl. Tax. 2(1), Kol/08-09/1582 of the assessee against an order of assessment dated 10th November, 2008 passed by

the Assessing Officer, being the Deputy Director of the income tax, International Taxation, 2(1) Kolkata, u/s 143(3) of the income tax Act, 1961

for the aforesaid Assessment Year 2006-07.

2. The assessee is a company incorporated in the United Kingdom, under the relevant laws of England and Wales. The assessee is the partner of P

& O Nedlloyed and hereinafter referred to as Nedlloyed, a partnership firm established in the United Kingdom, on 1st January, 1997. Nedlloyed

has two partners, the assessee and Nedlloyed BV a company incorporated under the laws of Netherlands, and hereinafter referred to as the Dutch

company.

3. Nedlloyed carries on business of operation of ships all over the world including in India. The global profit and loss of the partnership is shared

by its two partners, the assessee and the Dutch company in the ratio of 56:44 respectively.

4. P & O Nedlloyed India Private Limited, a company incorporated in India under the Companies Act, 1956, and a wholly owned subsidiary of

the assessee, is the authorized shipping agent of the partnership firm Nedlloyed in India and represents the partnership firm Nedlloyed in all

transactions in India.

5. As per the computation of total income earned by the assessee during the Assessment Year 2006-07, the assessee earned Rs.

5,29,15,48,931/- as gross freight, including ancillary charges from the operation of ships in India. The freight income shown, represents 56% share

of the assessee in the partnership firm PON.

6. The assessee has claimed that the income received by the assessee in India from the operation of ships, including ancillary charges, is exempted

from tax in India under Article 9 of the Indo-U.K. treaty to prevent double taxation, as the assessee is a tax resident of U.K.

7. The Assessing Officer did not, however, accept the aforesaid claim of the assessee to Income Tax relief under the Indo U.K. treaty. The

Assessing Officer was of the view that, to claim Income Tax relief under the treaty, income had to be taxable under the domestic law at the first

instance. The Assessing Officer observed that it defied all logic as to why the assessee was interested in taking recourse to Article 9 of the Indo-

U.K. treaty to claim exemption of Income Tax in India, since the assessee''s share of income from the firm was exempt under the domestic law

itself. Be that as it may, the question of whether the assessee is entitled to the benefit of exemption under the Indo-UK treaty is not in issue in this

appeal.

8. The definition of person u/s 2(31) of the income tax Act includes, amongst others, a partnership firm. A partnership firm is, therefore, a separate

taxable entity distinct from its partners. Section 10(2a) of the income tax Act provides that if a person is a partner of a firm which is separately

assessed, his share in the total income of the firm, shall not form part of his total income.

9. Nedlloyed is separately assessed to income tax under the income tax Act, 1961 under PAN AAFF955OK. Thus the assessee is not required

to pay any tax in relation to its share of profits in Nedlloyed.

10. The assessee sold 10,71,420 equity shares of its wholly owned subsidiary, Nedlloyed India Private Limited, hereinafter referred to as

Nedlloyed India to Maersk India Private Limited for consideration of Rs. 5,20,28,155/-.

11. As recorded in the judgment and/or order of the learned Tribunal under appeal, this sale was admittedly part of the overall reorganization of

the business of the assessee. The long term capital gain on sale of shares at a consideration of Rs. 5,20,28,155/- worked out to Rs. 2,58,76,351/-.

The assessee filed its Income Tax return for the Assessment Year 2006-07 on 29th November, 2006, declaring total income of Rs. 2,58,76,351/-

on account of long term capital gain. In the Income Tax Returns, the assessee also claimed credit for Tax Deduction at Source (TDS).

12. In the previous year 2005-06 corresponding to the Assessment Year 2006-07 Nedlloyed India Private Limited declared dividend amounting

to Rs. 14,99,98,800/- to its non-resident shareholders, i.e. the assessee. Admittedly, Nedlloyed India had earned profits and had cash surplus

and/or cash reserves for distribution of dividends, and accordingly the Board of Directors of Nedlloyed India Private Ltd. adopted a resolution at

its meeting held on 24th march, 2006, for distribution of dividends to the shareholders.

13. While arriving at the revised net worth of Nedlloyed India Private Limited, the valuers had made certain adjustments to the net worth of the

equity shares up to 31st March, 2006 including inter alia deduction of Rs. 17,10,36,000/- declared as dividend and paid to its shareholders from

its net worth.

14. By the order of assessment dated 10th November, 2008 the Assessing Officer assessed the income of the assessee at Rs. 17,12,57,331/- for

the Assessment Year in question, inter alia, upon increasing the value of the shares sold by the assessee after disallowing the deduction claimed on

account of distribution of dividend and also credit claimed for deduction of TDS from Nedlloyed.

15. The Assessing Officer arrived at the conclusion that the Nedlloyed group had resorted to the dubious method of declaration of payment of

dividend to avoid payment of tax on long term capital gains, inter alia holding:

Though the decision to sale out was taken much earlier, the blue print of tax avoidance was chalked out only towards the fag end of the financial

year 2005-06. The two companies of the Group involved in the transaction were in hurry to complete it and in the process they did not even

hesitate to violate the RBI norms. The whole process was completed even before the valuation report was obtained from the second independent

valuer viz. CBG & associates.

It goes on to show the culpable state of mind of the persons involved in the transaction.

The payment of dividend in the present case being a colourable transaction as established above, it cannot be considered as a part of assessee''s

tax planning and it clearly amounts to tax evasion. Hence, deduction is denied for the dividend paid for determination of the NAV per equity share.

Accordingly, the assessee''s income from LTCG and tax payable thereon will be as per calculation in Column ''B'' of the table above. Since the

element of mens rea is omnipresent in the transaction, penalty proceedings u/s. 271(1)(c) is separately initiated. There being no provision in the Act

which sanctions allowance of DDT paid by MIPL in the hands of the assessee, the entire capital gains tax liability plus interest is cast on the

assessee.

16. The appeal of the assessee, from the aforesaid order of assessment was allowed in part, inter alia sustaining the disallowance of credit for TDS

deducted from Nedlloyed, but setting the disallowance of the dividend distribution amount and addition thereof to the value of the shares of

Nedlloyed India Private Ltd. The appellate Commissioner held:

I have considered the submission of the appellant and perused the assessment order. I have also gone through the documents filed and the judicial

pronouncements relied upon by the appellant. During the relevant previous year, the appellant has sold 10,71,420 equity shares of Nedlloyed India

Pvt. Ltd. (NIPL) to Maersk India Pvt. Ltd. (MIPL). The NIPL was the 100% subsidiary of the appellate company. Since, the shares of NIPL

were not listed on the Stock Exchange and hence for the purpose of determination of NAV per equity share, the appellant has obtained valuation

reports of two Chartered Accountant Firms, namely M/s. BSR & Co. Chartered Accountants, the Statutory Auditors of the company and CBG &

Co., Chartered Accountants, a merchant Banker in category-I registered with SEBI, in accordance with the guidelines of RBI.

The audited balance sheet for the year ended on 31.3.05 was made the base by the valuers and the profit of the year ended on 31.3.06 was

added on the basis of unaudited accounts of NIPL. Besides, the valuers have made various adjustments including the dividend declared by NIPL

to arrive on the NAV per equity share and finally the FMV per equity share was determined at Rs. 48.56/-. Accordingly, as per the agreement

between the seller and buyer of shares, the appellant has received sale consideration of Rs. 5,20,28,155/-.....

** ** **

.....I am of the opinion that the A.O. was not justified in holding that declaration and payment of dividend by NIPL to the appellant was a sham

and colourable transaction. From the Balance-sheet of NIPL it is apparent that the Indian company was having substantial amount of Reserves &

Surplus and hence in the meeting of the Board of Directors of NIPL held at Beagle house, Braham Street, London E 18EP on 24.3.2006, it was

resolved that an interim dividend of Rs. 140/- per Equity Share of Rs. 10/- absorbing Rs. 14,99,98,800/- to be paid out of the brought forward

profits of the company for the period ended 28.2.06 on Equity shares of those shareholders whose name stand on the Register of Members as on

24.3.06. Accordingly, the dividend of Rs. 14,99,98,800/- was paid to the appellant by NIPL which was debited in its bank A/c on 28.3.06.

Further, NIPL in compliance to the provisions of Section 115-O of the I.T. Act, paid Dividend Distribution Tax (DDT) amounting to Rs.

2,10,37,332/- on 28.3.2006. Thus, it could be observed that NIPL has declared and distributed the dividend within the framework of law and

also paid substantial amount of dividend distribution tax u/s. 115O of the Act. The A.O. has not brought anything on record to prove that as per

law NIPL could not declare the dividend or as to whether there was any infringement of law on the part of NIPL or the appellant.....

** ** **

.....However, the fact is that NIPL has paid DDT amounting to Rs. 2,10,37,332/- u/s. 115O of the Act. Therefore, I am of the opinion that it

will be wrong to infer that to save tax of few lakhs, the appellant has resorted to this activity.

.....In view of above, it is held that the A.O. was not justified in adopting the FMV per Equity Share of NIPL at Rs. 184.25/-. He is directed to

compute the LTCG by adopting the FMV per share at Rs. 48.56/- and total sale consideration received by the appellant amounting to Rs.

5,20,28,155/-. The ground Nos. 7 to 10 are allowed.

17. The learned Tribunal dismissed the appeal of the revenue inter alia observing:

9. There is no dispute that distribution of dividend by NIPL prior to its sale by the assessee, even after the payment of dividend distribution taxes,

has resulted in tax advantage of Rs. 94 lakhs, but the fundamental question that we really need to decide is whether this declaration of dividend by

NIPL, just before sale of its shares to Maersk India, could be treated as a colourable device and part of impermissible tax avoidance scheme. One

of the allegations in the assessment order, as indeed in the grounds of appeal before us, is that the sale of shares is contrary to the RBI guidelines

but the learned Departmental Representative could not really demonstrate so. The Circular No. 16 of 2004, issued by the Reserve Bank of India

under the Foreign Exchange Management Act, deals with the issues regarding remittances of proceeds to the non resident, and it is not even the

case of the revenue that the price at which the shares are sold by the assessee are lower than the prices determined under the aforesaid circular. As

a matter of fact, the price at which shares are sold are arrived at in accordance with the above circular, and even the Assessing Officer does not

dispute that fact. The only controversy is that, as per the Assessing Officer, the sale of shares took place before the second valuation report, as

required under this circular, was obtained, i.e. one day after the sale took place, but then this fact does not lead to the conclusion that actual sales

price of share can be ignored....

10. It is important to bear in mind uncontroverted claim of the assessee that there were sufficient reserves and surplus, which were eligible for

distribution as ''dividend'', and the NIPL had sufficient cash balances as well. The nature of amounts distributed as dividend has not been altered as

a result of, what the revenue author ties describe as, colourable device to evade taxes. It is difficult to comprehend the rationale in revenue''s

approach.....The decision to distribute dividends, on these facts, cannot be termed as a ''dubious'' method to evade taxes; it is not a case where

dividend distribution exercise is not a bona fide exercise, is not intended to be acted upon and is used as a cloak to conceal a different transaction.

The fact that this distribution of dividend also ends up saving taxes on sale of NIPL shares cannot end up negating the effect of the lawful and

legitimate action of distribution of dividend by NTPL. We have also noted that the NIPL has duly paid dividend distribution tax and the same has

been duly accepted in its assessment. Once the taxes on distribution of dividend have been duly accepted, the character of such dividend payments

in the hands of the assessee cannot be recharacterized just because by such characterization of receipt, revenue ends up getting higher

taxes..... Undoubtedly, the course adopted by the assessee was tax advantageous inasmuch as if NTPL, assessee''s wholly owned

subsidiary, was not to distribute dividend and sell the shares without this exercise, the tax outgo would have been Rs. 94 lakhs more than under the

present arrangement, but then every tax advantageous action or inaction cannot be treated as a colourable device unless such an action or inaction

cannot be treated as a colourable device unless such an action or inaction is not bona fide, it conceals the true nature of transaction or is an

exercise without any commercial justification. In view of these discussions, and bearing in mind entirety of the case, we are of the considered view

that on the facts and in the circumstances of this case, distribution of dividend by NIPL, prior to sale of its shares by the assessee, even though tax

advantageous cannot be termed as a colourable device or sham transaction and the receipt of these dividends cannot be recharacterized as sale

consideration of shares in the hands of the assessee. We, therefore, approve and uphold the conclusions arrived at by the CIT(A) and decline to

interfere in the manner.

18. The question of law as framed in Paragraph 2 of the petition being GA No. 1061 of 2013 are as follows:

(i) Whether on the facts and in the circumstances of the case, the Learned Income Tax Appellate Tribunal erred in deleting the addition made by

the Assessing Officer u/s 93(1)(b) of the income tax Act, 1961.

(ii) Whether on the facts and in the circumstances of the case, the Learned Income Tax Appellate Tribunal erred in law in ignoring the decision of

the Hon''ble Supreme Court in the case of M. Ct. M. Chidambaram Chettiar Vs. Commissioner of Income Tax, Madras,

(iii) Whether on the facts and in the circumstances of the case, the Learned Income Tax Appellate Tribunal was justified in relying upon the

judgment of Madras High Court in Commissioner of Income Tax, Madras Vs. A.M. M. Mohammad Ibrahim Sahib, particularly when the

Assessing Officer had stated that the declaration of dividend prior to transfer of the shares was with intention to reduce the price of the shares and

thereby reduce the capital gains tax liability.

19. The first question, that is, the question of whether the Appellate Tribunal erred in deleting the addition made by the Assessing Officer is not a

question of law. The reference in the aforesaid question to Section 93(1)(b) of the income tax Act, 1961 is patently misconceived, as the said

section has no application in the facts and circumstances of this case.

Section 93 Sub-section (1) is set out hereinbelow for convenience:

93. Avoidance of income tax by transactions resulting in transfer of income to non-residents.--(1) Where there is a transfer of assets by virtue or in

consequence whereof, either alone or in conjunction with associated operations, any income becomes payable to a non-resident, the following

provisions shall apply -

(a) Where any person has, by means of any such transfer, either alone or in conjunction with associated operations, acquired any rights by virtue of

which he has, within the meaning of this section, power to enjoy, whether forthwith or in the future, any income of a non-resident person which, if it

were income of the first mentioned person, would be chargeable to income tax, that income shall, whether it would or would not have been

chargeable to income tax apart from the provisions of this section, be deemed to be income of the first mentioned person for all the purposes of

this Act;

(b) where, whether before or after any such transfer, any such first mentioned person receives or is entitled to receive any capital sum, the payment

whereof is in any way connected with the transfer or any associated operations, then any income which, by virtue or in consequence of the transfer,

either alone or in conjunction with associated operations, has become the income of a non-resident shall, whether it would or would not have been

chargeable to income tax apart from the provisions of this section, be deemed to be the income of the first mentioned person for all the purposes of

this Act.

Explanation.--The provisions of this sub-section shall apply also in relation to transfers of assets and associated operations carried out before the

commencement of this Act.

20. Where there is a transfer of assets by virtue or in consequence whereof, any income becomes payable to a non-resident, either alone or in

conjunction with associated operations, the provisions of section (a) and (b) are to apply.

21. In other words where there is a transfer of assets, as a consequence of which any income becomes payable to a non-resident, either alone or

in conjunction with associated operations, whether before or after any such transfer, or where any such first mentioned person receives or is

entitled to receive any capital sum, the payment whereof is in any way connected with the transfer or any associated operations, then any income

which by virtue or in consequence of the transfer, either alone or in conjunction with associated operations, has become the income of a non-

resident, whether it would or it would not have been chargeable to income tax apart from the provisions of the said section, are to be deemed the

income of the first mentioned person for the purposes of the Income Tax Act, 1961.

22. Section 93(1)(b) can have no application to the transactions in this case and, in any case, the Assessing Officer has not proceeded on the basis

of the aforesaid section. The judgment of the Supreme Court in M. Ct. M. Chidambaram Chettiar Vs. Commissioner of Income Tax, Madras,

Supreme Court can also have no application in the facts and circumstances of the instant case. The second section, which is, whether the income

tax Appellate Tribunal erred in law in ignoring the aforesaid decision is misconceived.

As very rightly pointed out by Mr. Porus Kaka appearing on behalf of the respondent, the learned Tribunal has not even referred to the judgment

in Commissioner of Income Tax, Madras Vs. A.M. M. Mohammad Ibrahim Sahib, The third question is also misconceived.

23. As recorded by the learned Tribunal the entire transaction relating to the transfer of the equity shares held by the assessee in Nedlloyed India

Pvt. Ltd. was indisputably part of the overall reorganization of business of the Nedlloyed group.

24. There was no legal bar to the distribution of dividends, which was done in accordance with the provisions of the Companies Act, 1956. The

Revenue has not been able to demonstrate any illegality in the distribution of dividend, in view of admitted cash reserves and surplus for such

distribution.

25. The learned Tribunal as also the Appellate Commissioner did not agree with the finding of the Assessing Officer that distribution of dividend

was a colourable device to avoid tax on long term capital gains of the assessee and liable to be ignored in computation of long term capital gains.

The learned Tribunal as also the Appellate Commissioner in effect and substance concurred in their factual finding that there was no illegality in the

distribution of dividend, which was authorized in the meeting of the Board of Directors held on 24th March, 2006.

26. The decision to distribute dividends was found not to be a dubious method to evade taxes. The learned Tribunal very rightly found that

dividend distribution tax had duly been accepted. Having accepted dividend distribution tax, the Revenue could not question the legality of

distribution of dividend. The learned Tribunal rightly held that if there was no legal infirmity in distribution of dividend, the mere fact that such

distribution of dividend ended up in saving taxes on sale of share would not invalidate the distribution of dividend.

27. The learned Tribunal, by its judgment and order under appeal found, on consideration of materials on record before it, that the share valuation

had been done in due compliance of the guidelines laid down in Reserve Bank of India Circular No. 16 of 2004. The aforesaid finding cannot be

assailed in an appeal u/s 260A of the income tax Act. In any case, even before us the Revenue has not been able to show how and in what manner

the said circular has been contravened.

28. The onus was on the Revenue to demonstrate the illegality, if any in the judgment and order under appeal. Concurrent findings of facts that the

share valuation did not suffer from any infirmity cannot be interfered with in an appeal u/s 260A of the income tax Act, 1961.

29. There is no question of law far less any substantial question of law involved in this appeal. The Questions of Facts cannot be determined in an

appeal u/s 260A of the income tax Act.

30. The questions suggested by the Revenue can hardly be said to apply in the facts and circumstances of the instant case.

31. The Revenue has not been able to demonstrate any such infirmity in the order of the learned Tribunal that calls for interference from this Court.

The appeal is, therefore, not entertained and the same is dismissed.